

## **1. PERFORMANCE AUDIT OF PERSONNEL SYSTEMS**

### **Background information**

As a consequence of fiscal pressures and the increasing need for citizen services, the North Carolina General Assembly recognized that it must reduce the costs of program service delivery and identify more efficient and effective ways of:

- Organizing, administering, and delivering services and programs
- Strengthening the State's financial planning, budgeting, and management systems
- Procuring and providing goods and services

The North Carolina General Assembly, in its 1991 session, authorized a year-long performance audit of all branches of State government to assist in evaluating government operations, restructuring and reforming service delivery, strengthening management practices, improving government efficiency and effectiveness, establishing priorities, and preserving and improving the quality of State services.

To facilitate the achievement of these goals, the Legislative Services Commission created a Government Performance Audit Committee (GPAC). GPAC is co-chaired by the Speaker of the House and President Pro Tempore of the Senate. In addition to the co-chairs, GPAC includes six members of the General Assembly, the State Auditor, and ten private sector leaders of North Carolina, who are organized in three subcommittees:

- Organization/staffing and personnel
- Planning, budgeting, program evaluation, and the financial model
- Information technology/telecommunications and purchasing

The performance audit was organized into two phases. The objective of the first phase was to review five major management systems:

- Planning, budgeting, and program evaluation
- Personnel
- Purchasing
- Technology

- Organization and staffing patterns

GPAC engaged KPMG Peat Marwick to assist in conducting Phase I of the performance audit. To facilitate the work of each subcommittee, Peat Marwick formed six functional teams that correspond to the five major segments listed above and the development of a financial model for projecting General Fund revenues and expenditures by major program.

In Phase II an analysis will be made that will build upon Phase I findings and recommendations. The analysis will focus closely on how individual program service delivery and management systems can be redesigned to better achieve mission-related outcomes in the most cost-effective manner.

This performance audit report addresses and recommends solutions to a wide range of management system issues related to personnel. Findings related to other functional areas are cross referenced to their specific performance audit reports (e.g., organization and staffing, budgeting, purchasing, information technology), as appropriate.

Human resource management recommendations in this Phase I report address the State's key systemic personnel problems and issues. The report also addresses personnel problems cited by the General Assembly in its request for performance audit services.

#### **Audit objectives and scope**

The objectives of the Phase I performance audit of State personnel management were to:

- Determine how effective the personnel system was in attracting, retaining, motivating, and developing the State's workforce
- Assess if the State personnel functions provide comprehensive human resource management in the following areas:
  - Workforce planning
  - Recruiting plans
  - Job evaluation and job classification programs
  - Compensation plan
  - Employee training and development
  - Performance management
  - Human resource information systems
  - Equal employment opportunity
- Assess if personnel procedures, processes, and tools are aligned with the purpose and mission of North Carolina State government today

- Recommend specific issues and elements of the personnel system that require in-depth analysis in Phase II of the audit based on those areas that are identified as having the most opportunity for improvement

The North Carolina statewide government personnel systems under review in this performance audit comprise all three branches:

- Executive
- Judicial
- Legislative

As of 1991, the executive branch was by far the largest branch with approximately 207,000 positions, which includes 118,000 State-funded positions in the local public schools and community colleges. The judicial branch and the legislative branch have approximately 4,500 and 150 positions, respectively.

Our review of the statewide personnel function focused on all employees within the three branches, excluding the positions in the local public schools, community colleges, and the university system.

#### **Audit criteria**

To address the objectives of the performance audit, Peat Marwick personnel consultants developed assessment criteria to evaluate the performance of State personnel systems. The criteria were developed based on generally accepted principles of human resource management, Peat Marwick's experience in assessing other personnel departments, and guidance provided by the GPAC subcommittee on personnel and organization/staffing. The following assessment criteria were used to focus diagnostic interviews, guide fact-finding, and form the basis of our assessment of the State's personnel systems:

- Management and line employees are provided with appropriate direction, tools, technology, and a human resource management infrastructure to accomplish their program mission and provide quality services
- The best and most qualified people are attracted and retained to serve and work in appropriate positions in the organization
- Employees are motivated to increase productivity and provide quality services through a performance-based reward system

- Compensation, job classification, and employee benefit plans are effectively and efficiently designed and executed to maximize the utility of the funds allocated for rewarding performance and ensuring the well-being of employees
- Employees are provided with opportunities for advancement through annual job performance evaluations and the effective application of training and development
- Employee training and development programs are effective, economical, and directed, to ensure that maximum benefits accrue to the organization

### **Methodology**

This section presents the methodology and work plan used to conduct the personnel performance audit. This analysis was performed in conformance with generally accepted practices for a human resource diagnostic review and is in accordance with government auditing standards

#### **Preliminary survey**

Peat Marwick conducted a preliminary survey of the personnel systems in each of the three branches of State government. The preliminary survey consisted of the following work steps:

- Gathered and reviewed information on mission, programs, key issues, and status of human resource practices in the State's personnel programs
- Interviewed key managers responsible for human resource practices in the three branches to identify:
  - Key issues and concerns regarding human resource management in the 1990s
  - Important aspects of personnel programs
  - Organization of personnel system
  - Operating methods
- Reviewed available branch policies and procedures on personnel issues
- Reviewed available long-term personnel plans
- Reviewed past management reports, studies, and audit reports regarding the personnel function
- Attended State Personnel Commission meetings in the executive branch and State Personnel Study Commission meetings in the legislature

- Interviewed key individuals and collected information on the State Health Plan and the Retirement System
- Gathered and established trends from State personnel-related historical data
- Reviewed the GPAC employee survey and prior studies
- Reviewed existing personnel plans and State employee association proposals
- Sourced and assimilated appropriate public and private sector comparative data for benchmarking

#### **Field work and analysis**

Once the preliminary survey was completed, Peat Marwick reported to the subcommittee and the most important issues that needed field work and analysis were identified. These issues became the focus for the remainder of Phase I of the performance audit. Once the primary issues were selected for further analysis, Peat Marwick proceeded with the field work and analysis.

To gain a perspective of human resource management at the agency level and to further analyze the primary issues, we interviewed agency personnel directors, position management managers, training and development managers, and salary administration managers in the following executive branch agencies:

- Department of Administration
- Department of Agriculture
- Department of Human Resources
- Department of Transportation
- Employment Security Commission

These agencies were selected because they have a broad cross-section of State employees and represent approximately 60 percent of the State's workforce that was to be reviewed during Phase I. Reviews at the agencies were limited to diagnostic interviews of key managers. In addition to interviews, comparisons to other states and the private sector were made when applicable and innovative governments and states were interviewed to determine what steps they were taking to make their human resource functions more responsive to organizational needs. Based upon the criteria and analyses performed, findings and recommendations were developed.

It is important to note that Phase I field work consisted of limited diagnostic rather than in-depth personnel analysis so that overriding issues could be identified and prioritized for Phase II analysis and/or assessment independent of the government performance audit.

### **Reporting**

In accordance with Phase I requirements, this report summarizes our major findings and recommendations as well as areas of opportunity that warrant further analysis in Phase II.

## **2. CURRENT SITUATION**

This section presents the current situation of North Carolina's State government personnel practices, its organization, and key features of the compensation and benefits it offers its employees who are covered by the State Personnel Act. It is organized and presented in the following order:

- Human resource management practices
- Profile of the State workforce
- State personnel offices
  - Executive branch
  - Judicial branch
  - Legislative branch
- Compensation and employee benefits
- Training and development

Exhibit 2-1 provides a historical perspective of some key events that have affected the organization and management of the State's personnel systems today.

### **Human resource management practices**

Today's poor fiscal environment and the size of the government's investment in its workforce demand a contemporary approach to managing its human resources--one that maximizes productivity and delivers citizen services effectively. Successful management of the human resource function can result in increased employee morale, motivation, and empowerment of employees, which ultimately results in better service to the public.

In North Carolina today, State government provides more services to its citizens than ever before--in a national period of difficult fiscal times. These tough times require "smart" strategies for:

- Educating millions of students in local public schools, community colleges, and public universities
- Maintaining over 77,000 miles of safe and adequate roads and highways

## **EXHIBIT 2-1**

### **Key Historical Milestones in the Management of North Carolina State Government Personnel**

- The federal Civil Service Act of 1883 is the basis of North Carolina's (and most governments) personnel system. It sought to establish a merit system for the trade and clerical workers.
- In 1925, a State Commission created the State's first classification system to resolve salary inequities for the 1,600 executive branch employees with like jobs. Its recommendations led to the creation of the executive branch Office of State Personnel (OSP). In addition, the Commission recommended that job candidates have appropriate position qualifications, unnecessary positions be eliminated, and employee attendance and leave policies be better managed.
- The Great Depression of 1929 caused the State budget to be reduced by one-third and the salaries of State workers to be cut by 20-25 percent.
- In 1949, the State implemented a position classification and compensation plan. The 1949 act has been modified and modernized, but still remains the basic legislation for the system.
- After 1950, North Carolina experienced significant economic growth and an increase in the State government's involvement in such areas as integration, environmental programs, human services, and crime prevention.
- In 1965 Chapter 126 of the State charter was rewritten to reorganize the old State Personnel Department and State Merit System into one agency within the Department of Administration.
- In 1971, the General Assembly passed the Executive Reorganization Act, which combined 350 separate executive branch agencies, boards and commissions into less than 20 executive departments. The responsibilities and organization of the Office of State Personnel virtually remained unchanged.
- In 1985, the Governor's Efficiency Study Commission reviewed the executive branch department and discussed 414 recommendations for improving administration and service delivery, including six recommendations for the Office of State Personnel.
- Over time, agreements were made with eight agencies and ten universities that allow the agencies/universities to make decisions regarding their employee position classifications. Agreements were also made to address other aspects of personnel management at the agencies.



- Operating a system of justice and public safety with over 1,000 judges and magistrates, 2,300 law enforcement officers, and 91 correctional facilities, housing approximately 22,000 inmates
- Delivering diverse natural, human, and economic resource services, and general government activities that touch the lives of all citizens in North Carolina

For the State to carry out its programs and deliver citizen services in a cost-effective manner, it must maintain a skilled, experienced, and motivated workforce. State employee salaries and benefits represent one of its largest expenditures. Approximately \$3.8 billion each year pays for services of State personnel. Not included in this amount are the majority of public school and community college systems salaries.

Strategies for maximizing the return on this investment involve a shift in human resource management from a hierarchical, control-oriented approach to a more supportive, participative style of management. Exhibit 2-2 illustrates some of the elements of these shifts pertinent to state-of-the-art human resource management practices. Today's human resource management function requires an integrated approach to managing an organization's personnel function that contains the following key human resource functions:

- Recruitment and selection
- Compensation and classification
- Performance appraisal
- Training and development
- Employee relations
- Equal employment opportunity

It involves a comprehensive human resource function that is planned, organized, and evaluated on the basis of its contributions to achieving an organization's objectives. The development and implementation of a contemporary and comprehensive human resource management program will enable North Carolina to do more with its current resources, eliminate wasteful and unproductive activities, and increase output and outcomes of its activities so that they meet the needs and expectations of its citizens in the most cost-effective manner.

### **Profile of the State workforce**

North Carolina employs about 212,000 full-time workers within its three separate branches of government:

## Exhibit 2-2

### Shifts in Human Resource Management

Yesterday	Today
Hierarchical style	Participative style
Achieving quality through inspection	Building quality into the process
Top-down information flow	Top-down, lateral, and upward information flow
Inward focus on quality	Customer-defined quality
Intuitive and subjective plans	Planning based on validated measures of quality
Short-term planning	A vision for the future
Competition among divisions and between headquarters and the field	One team pulling together
Episodic improvements	Comprehensive and continuous improvements
Top-down initiatives	All staff involved and engaged

- The legislative branch, primarily the General Assembly, consists of 170 elected Senators and Representatives who are elected from districts throughout the State. The General Assembly has a centralized legislative services staff that is directed by the Legislative Services Commission. There are currently 154 permanent full-time positions supporting the legislature, the majority of which are organized into six divisions. Approximately 340 temporary session-only staff that are hired each year also to support the General Assembly.
- The judicial branch administers State law through a unified court system of trial courts and courts of appeal. The judicial branch's mission is different from most other states in that it extends not only to its courts but to diverse components of the civil and criminal systems, such as probation and aftercare services. There are 4,505 positions in the judicial branch: 3,347 of these positions are court-related positions, 520 are in the district attorneys' offices, 249 are public defender-related positions, and 389 are probation and parole-related positions.
- The executive branch, consisting of the Governor and the Council of State, introduces new legislation, enforces the law, and administers the delivery of programs and services to the citizens of the State. The executive branch employs or directly funds the positions of approximately 207,000 employees. Exhibit 2-3 lists the relative sizes of executive branch agencies.

The scope of this personnel performance audit includes all those employees subject to the Personnel Act (SPA), specifically Chapter 126 of the North Carolina General Statutes. As of December 31, 1991, approximately 75,000 positions, or one third of the State's employees, were of this type. In conformance with the Act, an SPA employee belongs to one of 4,891 State job classifications. A classification, or job grade system, is a system by which jobs are classified and grouped according to a series of predetermined wage classes. Successive grades require increasing amounts of job responsibility, skill, knowledge, ability, and/or other factors selected to compare jobs. The specifications for each of the job classifications constitute the scale against which descriptions for individual positions are compared. SPA job classifications exist for all types and levels of positions.

The remaining 135,000 employee positions are exempt from the Personnel Act (EPA). EPA positions do not conform to SPA standards for salary grades, employee benefits, and employee grievance procedures. Public school, community college and university positions are outside the scope of Phase I of the performance audit.

The EPA positions that are subject to this audit are approximately 6,000 "employment-at-will" positions that are generally senior management and office holders with policy-related responsibilities in the executive branch, and another 12,000 "exempt" positions in the legislative and judicial branches and the university system.

**Exhibit 2-3**  
**Number of Positions by Department**

Department	Total
<b>Legislative Branch</b>	154
<b>Judicial Branch</b>	4,505
<b>Executive Branch:</b>	
Public School System*	107,000
University System*	28,008
Dept. of Human Resources	17,735
Dept. of Transportation	13,668
Dept. of Correction	12,849
Community Colleges*	10,000
Dept. of Community Colleges	205
Dept. of Envir. Hlth. & Nat. Res.	4,145
Dept. of Econ. & Comm. Dev.	3,001
Dept. of Crime Ctrl. & Pub. Saf.	2,263
Dept. of Agriculture	1,414
Dept. of Revenue	1,385
Dept. of Justice	1,006
Dept. of Administration	920
Dept. of Public Instruction	866
Dept. of Cultural Resources	706
Dept. of Insurance	348
Dept. of Labor	325
Office of State Controller	289
State Treasurer's Office	241
Governor's Office	225
State Auditor's Office	151
Office of State Personnel	127
Secretary of State	114
Misc. Boards, Councils, & Comm.	108
Lt. Governor's Office	12
	<u>207,111</u>
<b>Total</b>	<u><u>211,770</u></u>

\* Not within the scope of this audit

Sources: All information is from the State's Personnel Management Information System as of December 31, 1991, except for positions in the Public School System, Community Colleges, and certain exempt positions in the University System, which were obtained from the Office of State Management and Budget as of July, 1991.

## **State personnel offices**

This section provides an overview of the human resource function and how it is organized in each of the three branches of State government.

### **Executive branch**

Responsibility for the various executive branch personnel functions is vested in many sources, including the General Assembly, the Governor, the State Personnel Commission, Office of State Personnel (OSP), agency personnel staff, and every supervisor/manager in State government. The Personnel Act gives direction to the Governor and the State Personnel Commission on personnel administration for the executive branch. The Act only applies to the legislative and judicial branches for Articles 6 and 7, Equal Employment Opportunity, and Privacy of Records. Accordingly, OSP has no responsibility for personnel administration at the legislative and judicial branches.

The State Personnel Commission is responsible for establishing OSP policies and procedures. The State Personnel Director is responsible for the day-to-day execution of those policies and procedures.

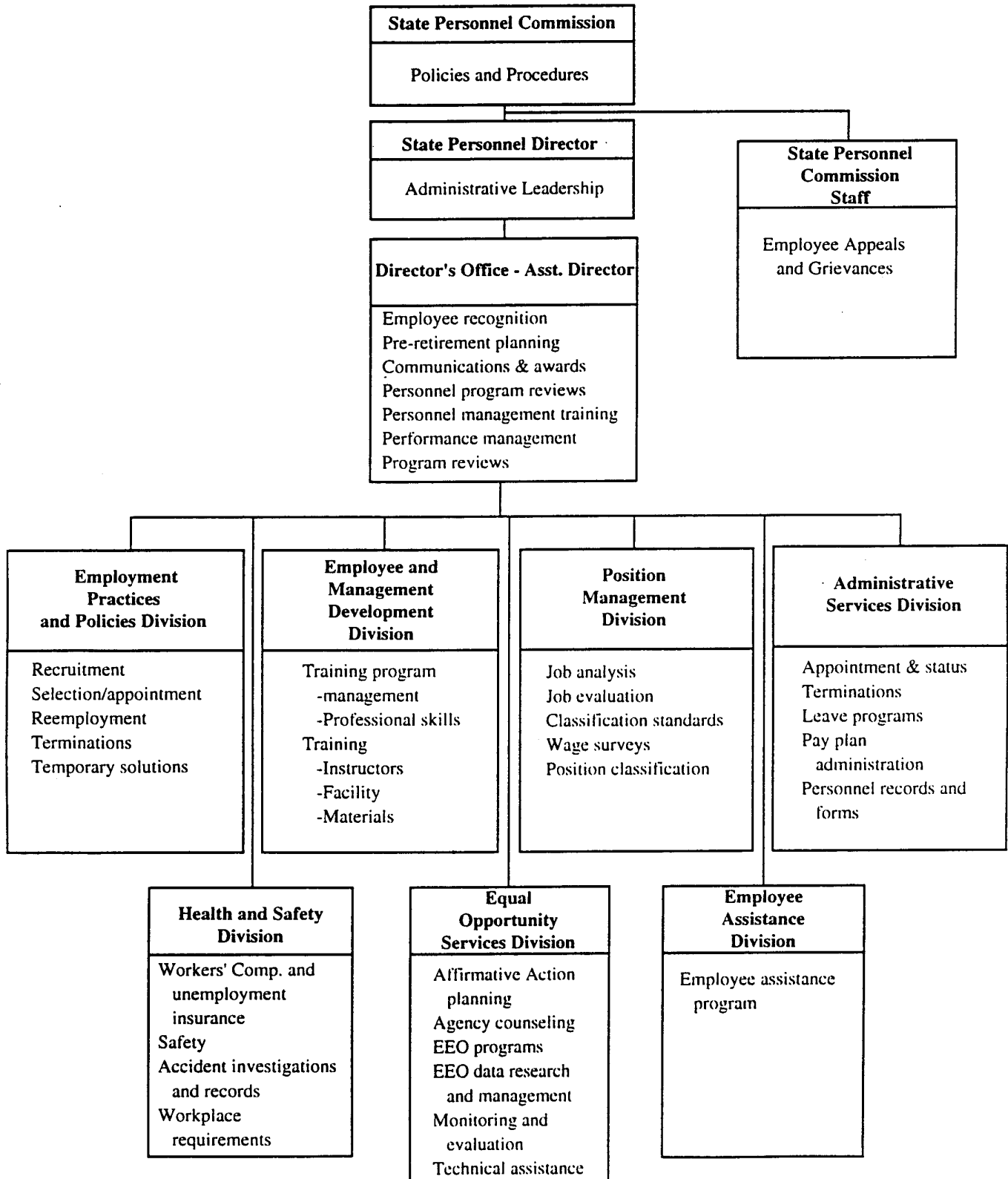
Currently, OSP is only responsible for those executive branch employees subject to the Personnel Act (i.e., SPA employees) and does not oversee executive branch "exempt" employees (i.e., EPA employees). Exhibit 2-4 provides an organization chart depicting OSP division responsibilities. The two largest divisions within OSP are:

- The Administrative Services Division - responsible for the day-to-day administration of the pay plan as it relates to promotion, demotion, reallocation, transfer, and reinstatement of employees.
- Position Management Division - primarily responsible for establishing and maintaining the State's position classification and pay plan for approximately 75,000 SPA positions in 4,891 SPA classifications, except for positions within eight agencies and ten universities where position management authority agreements have delegated limited authority to these organizations to make their own decisions regarding individual classifications that are subject to the routine monitoring and periodic auditing by the Division.

### **Judicial branch**

The judicial branch employs approximately 4,505 employees. The Personnel Division in the Administrative Office of the Courts is responsible for administering all human resource management functions in the judicial branch. The division has 20 positions organized into three functional areas:

# Exhibit 2-4 Organization of the Executive Branch Office of State Personnel



- Compensation and benefits administration
- Staff development and training
- Employee relations

Exhibit 2-5 shows the Personnel Division organizational chart that depicts division responsibilities.

### **Legislative branch**

The General Assembly employs 154 permanent employees and 340 temporary session employees. The temporary employees are utilized during the short and long session of each biennium when the level of work increases significantly and legislators need temporary full-time support staff. The short session occurs in even-numbered years and usually lasts four to six weeks beginning in late May/early June. The long session occurs in odd-numbered years and usually runs from January to July. Currently, the Legislative Services Commission (LSC) governs the administrative oversight of the operations of the General Assembly, which includes the personnel function. The LSC is permitted under Chapter 120-32 to authorize the number, titles, classifications, functions, compensation, and other conditions of employment of the joint legislative service employees of the General Assembly.

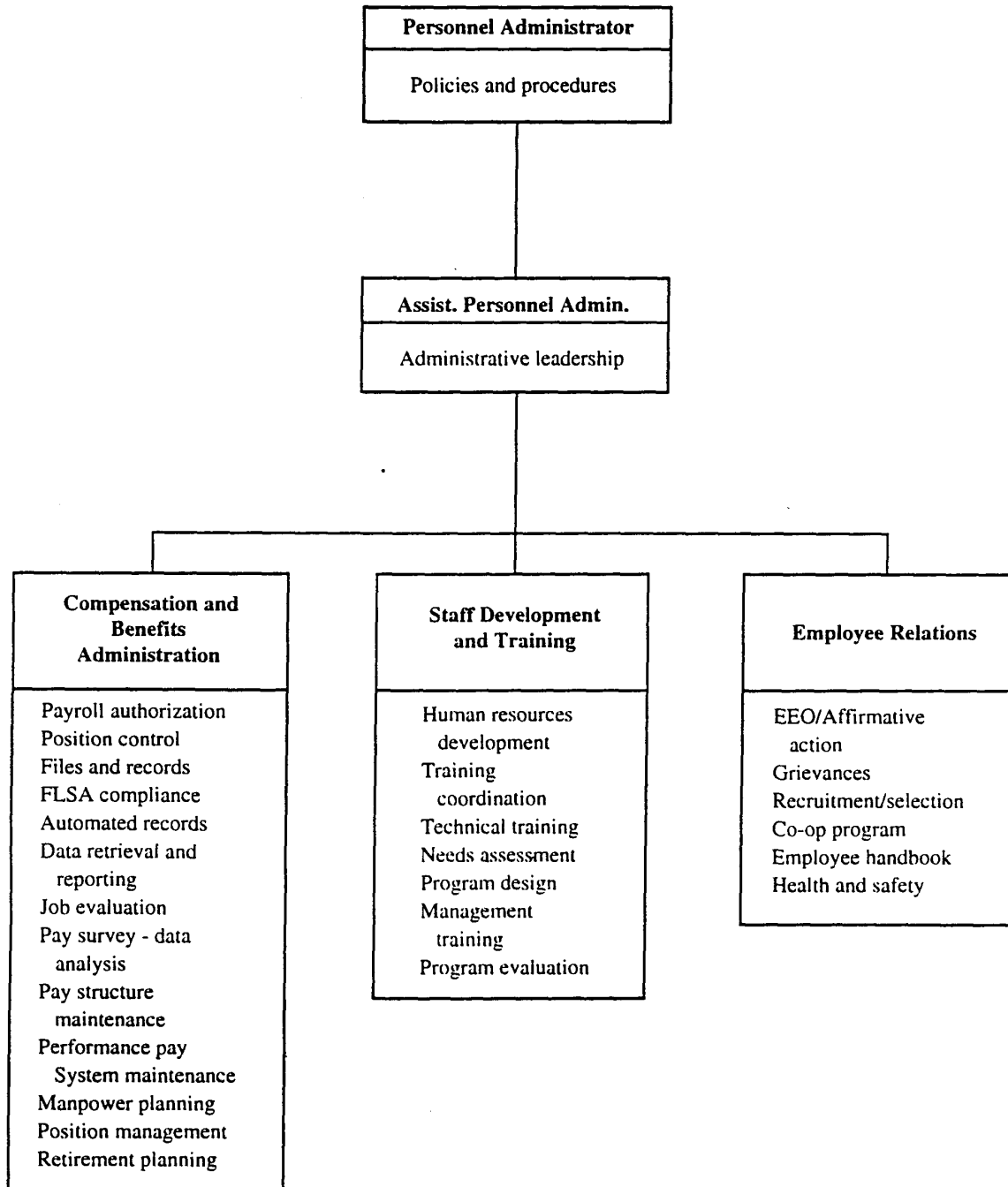
The Legislative Administrative Officer, who reports to the LSC, has the primary responsibility for managing all personnel-related functions in the General Assembly. He receives administrative assistance from the Budget Officer for payroll processing and record keeping. There is no organized personnel division within the legislative branch.

### **Compensation and benefits**

As of December 31, 1991, the average State SPA employee's salary was \$24,665. The following table presents the distribution of SPA positions within salary range increments based on OSP's Personnel Management Information System.

<b>Salary range increment</b>	<b>Percentage of SPA employees within salary range increment</b>
\$15,000 or less	7.1%
15,001 to 25,000	57.6%
25,001 to 35,000	22.3%
35,001 to 45,000	8.3%
45,001 to 55,000	3.0%
55,000 or more	1.7%

# Exhibit 2-5 Organization of the Judicial Branch Personnel Services Division





Employee benefits as a percentage of the average employee salary is 42.8 percent (including longevity pay). A breakdown of the costs associated with offering individual benefits to State employees (active and retirees) is listed below.

<b>Employee Benefits</b>	<b>Percentage of Salary</b>
Paid leave (vacation, sick, and holidays)	16.4%
Retirement (includes life ins. and disability income)	11.9%
Social Security	7.8%
Health benefits	5.2%
Longevity pay	<u>1.5%</u>
Total	42.8%

A brief description of key employee benefits provided by the State is presented below.

#### **Retirement benefits**

The State administers five retirement systems covering various groups of employees. Three of the systems cover State government employees, and the other two cover other types of public employees (e.g. firemen and National Guard employees). The following three systems cover State employees:

- The Teachers' and State Employees' Retirement System provides retirement benefits for the following:
  - State agencies and institutions, including General Assembly employees
  - Teachers and employees of local boards of education
  - University and community college faculty and employees
  - State-employed law enforcement officers
- The Consolidated Judicial Retirement System provides retirement, disability, and death benefits for:
  - Judges
  - District attorneys
  - Clerks of the court
- The Legislative Retirement System is comprised of former members of the General Assembly. The plan provides retirement and disability benefits.

All three of these systems are funded by employee and employer contributions.

After one year of employment, life insurance is provided for the employees under the Teachers' and State Employees' Retirement System through the Death Benefit Plan. This is equal to the lesser of an employee's annual pay or \$50,000.

Long-term disability (LTD) coverage is provided through the Disability Income Plan of North Carolina after five years of employment. The LTD benefit is equal to 65 percent of an employee's monthly wage to a maximum of \$3,900.

Various agencies allow their employees to purchase additional insurance through payroll deductions. Such insurance may include a dental or cancer program or other similar type of coverage.

### **Health benefits**

The State currently offers its employees and retirees medical coverage through a self-funded program that includes:

- 1) An indemnity program administered by Blue Cross and Blue Shield of North Carolina (BCBS)
- 2) Four health maintenance organizations (HMO)

Under current law, the State is required to pay the full cost of an employee's or retiree's coverage under the indemnity plan and employees and retirees must pay the full cost for dependent coverage. Employees and retirees who elect HMO coverage must pay an additional amount, since the HMO rates are adjusted to reflect the higher benefit levels offered under the HMO.

The indemnity medical program recently increased the benefit contributions required to be made by State employees and retirees. The contributions were increased because of the continuing escalation of the plan's medical costs combined with other State fiscal pressures that led to the State's sharing more of its costs with plan participants.

North Carolina's medical benefit program, like most other states' benefit programs, is experiencing increasing costs. The main reason for this increase has been the continuing explosion of medical care costs. North Carolina is faced with the prospect of finding ways to control these costs or generate additional revenues, while at the same time providing meaningful benefits that continue to attract and retain qualified employees.

Between 1983 and 1991, the State experienced a medical program cost increase of over 225 percent per employee. When the growth in the number of employees and dependents is factored in, the State's expenditures for medical care has increased \$273 million, from \$92 million to \$365 million. The plan administrator has projected the total cost of the

medical program to be \$550 million for the 1992 plan year. The cost of the medical program makes the State the largest purchaser of health care in North Carolina.

### **Training and development**

The OSP's Employee and Management Development Division is responsible for planning, developing, and conducting training programs that focus on the management and professional skills needed to effectively manage employees.

The division offers a Public Manager Program designed to develop the skills of middle managers. Agencies are allowed to send a limited number of their managers to the program. For the 1993 program, a total of 146 managers were allowed to enroll for the course. This represents a 50 percent increase (from 1988) in the number of managers allowed to enroll in the course, yet it still represents less than one-tenth of one percent of the middle managers who are eligible for the course.

Other programs that are offered by OSP are:

- Introduction to supervision
- Fundamentals of management
- Computer skills training

Computer skills training is available to all State employees and is the only occupational skills training available to all employees from OSP. All other occupational skill courses are provided by the agencies.